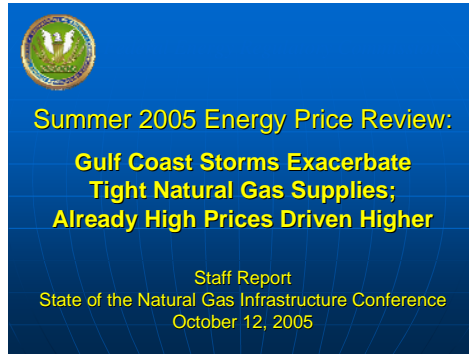


## Script for the Presentation of the Summer 2005 Energy Price Review



Good morning Mr. Chairman and Commissioners, panel members.

Today, staff is releasing our review of energy prices for the summer of 2005 titled “Gulf Coast Storms Exacerbate Tight Natural Gas Supplies, Already High Prices Driven Higher.” I’d like to spend a few minutes reviewing the major observations from that report.

Prices for Energy Increased Through the Summer		
	Price Changes (April to Late August)	Price Changes (Late August to Late September)
Natural Gas (Henry Hub*)	33%	44%
Crude Oil (West Texas)	21%	0%
Coal (Powder River Basin)	16%	8%

This summer, the United States experienced extraordinary increases in prices for all types of energy, and unprecedented increases in price for natural gas. Hurricanes Katrina and Rita exacerbated already tight supply and demand conditions, increasing prices for fuels in the United States further after steady upward pressure on prices throughout the summer of 2005. Most of this price pressure was due to the combined effects of oil prices and increased electric generation demand for natural gas caused by years of investment in gas-fired generation and a significantly warmer-than-average summer.

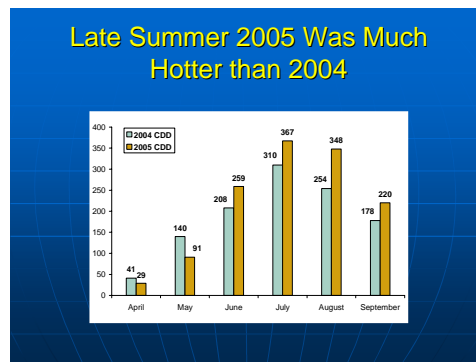
In early April, next day natural gas prices delivered at Henry Hub, Louisiana averaged about \$7.40/MMBtu (the standard units of natural gas prices). Henry Hub is the location we tend to use to represent production-area natural gas in the US. By late September, prices at Henry Hub – or at a nearby alternative location for the period that Henry Hub was physically out of service due to hurricane damage – almost doubled to

more than \$14.00/MMBtu. Prices remain today in the mid-\$13.00 range.

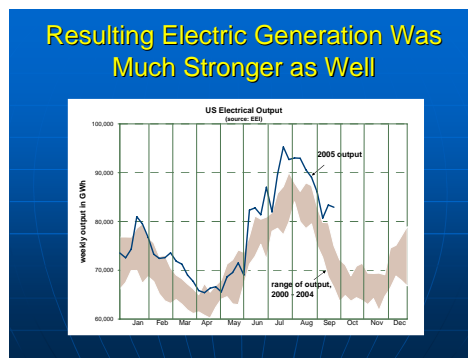
There's no denying the important effect of the hurricanes on natural gas prices. However, we see on this slide derived from Table 1 of the report that prices had already risen by a third from that \$7.40 level in early April to almost \$10.00/MMBtu before the hurricanes struck. I'd like to first spend a little time discussing that pre-hurricane price increase.

An important driver of pre-hurricane gas price increases was the price of oil, which rose 21% from the equivalent of about \$9.40/MMBtu in early April to over \$11.40 by late August before the hurricanes struck. Consequently, oil doesn't explain all of the gas price increase.

Staff analytic work over the past few years has indicated that natural gas prices are strongly influenced by two factors: oil prices and scarcity of natural gas. The gas market had been tight through the summer before the hurricanes, and it is useful to review why.



The summer of 2005 was abnormally hot. As measured in population-weighted cooling degree days calculated by the National Climatic Data Center, the period from June through August was the hottest on record – and 26% hotter than 2004. This chart, which is from Figure 2 of the report, shows a hotter September as well.

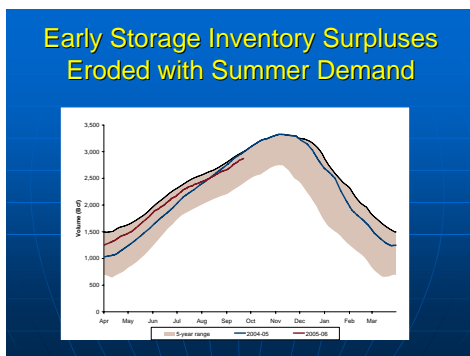


As a result, electric generation from June through September was significantly greater than generation over the preceding 5 years. This chart, which is Figure 5 in the report, shows the Edison Electric Institute's figures on electrical output for the year.

With the heavy addition of natural gas generation investment over the past decade,

we would expect that increased electric demand would drive increases in natural gas demand. The statistics available to us bear this out.

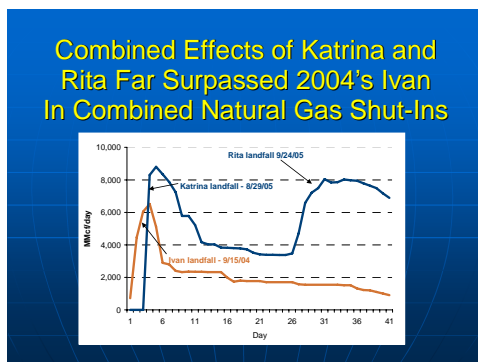
Using the Energy Information Administration's Monthly Electricity Flash Estimates, we can develop a sense of electric generation by fuel for June and July. Overall generation increased by 6% over 2004 for those two months. Generation by almost all fuel types increased, but generation from natural gas increased the most by far – 21% for those two months over 2004 levels.



To understand the effect that additional demand had on natural gas, the most accessible data is storage inventories. In early April, the EIA reported that storage inventories were about 225 Bcf above the preceding 5-year average. By late September, that advantage had dropped to 40 Bcf. More strikingly, as the graph (which is also Figure 3 of the report) shows, the injection rate has been much lower than last year's.

While not resulting in immediate scarcity, it appears clear that the strain on the system of a hot summer did have an effect on natural gas prices as buyers and sellers took into account tighter conditions for entering the winter than in the past couple of years.

In effect, anticipation of tightness seems to have affected prices even before the hurricanes struck. The likelihood of a bad hurricane season was understood when the National Oceanic and Atmospheric Administration increased its already above-normal forecast of hurricanes on August 2. Market participants were familiar with the potential for disruption in the Gulf following Ivan in 2004.



Hurricane Katrina, and later Hurricane Rita had and continue to have significant effects on Gulf Coast production. This graph, also Figure 4 in the report, plots gas shut-

in in the Gulf over time starting with landfall for Katrina through Rita against the experience last year with Ivan. As you can see, the effects of Katrina and Rita are greater and are proving more enduring than for Ivan. These effects brought prices for natural gas up an additional 44% from pre-hurricane levels, with little relief since.

**Natural Gas Prices are Likely to Remain High Through Winter**

- Current storage inventories remain above 5-year averages
- Timing for repair of infrastructure from the Gulf is not clear – will continue to stress system
- Supply tightness largely a function of winter weather

In general, we see the beginning of a winter season with a new set of dynamics likely to drive prices over time. Fortunately, current storage inventories remain above 5-year averages. The timing, however, for repair of Gulf infrastructure remains unclear and continued outages could stress the system.

We are, in effect, at the point where heating season demand, and to some extent anticipation of that demand, are likely to drive prices. Over the next month or two, any major new forecasts of winter weather will probably elicit price responses. When we enter the heating season itself, relative cold periods are likely to have strong effects on price.

We start at production-area prices already above \$13.50/MMBtu – close to 2½ times as high as last year. Our report, available on the Commission’s website, makes clear that the most significant reasons for this increase in price are factors like oil price increases, heavy electric generation demand, and hurricane disruptions.

With the support of Bob Flanders, who leads Oversight’s natural gas team and Dean Wight who leads the electricity team, I’m happy to answer any questions.